

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY)	
)	
Annual formula rate update and revenue requirement)	Docket No. 14-0312
reconciliation under Section 16-108.5 of the)	
Public Utilities Act.)	

REPLY BRIEF ON EXCEPTIONS OF
THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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ORAL ARGUMENT REQUESTED

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NOW COME the People of the State of Illinois (“AG” or “the People”), by and through Lisa Madigan, Attorney General of the State of Illinois, pursuant to Part 200.830 of the Illinois Commerce Commission’s (“the Commission” or “ICC”) rules, 83 Ill. Adm. Code Part 200.830, and in accordance with the schedule established in this docket, hereby file their Reply Brief on Exceptions to the Brief on Exceptions filed by Commonwealth Edison Company (“ComEd” or the “Company”) in this docket on October 23, 2014. Specifically, the People will address ComEd’s arguments on the issue of recovery of Annual Incentive Program (“AIP”) incentive compensation expense.

The People’s lack of comment on other issues in ComEd’s Brief on Exceptions, or on Briefs on Exceptions filed by other parties, should not be interpreted as support of, or opposition to, those other issues or other Briefs on Exceptions.

I. COMED’S SUPPORT FOR THE 102.9% AIP RECOVERY LEVEL IN THE PROPOSED ORDER LACKS MERIT.

The Proposed Order (“PO”) would allow recovery of ComEd’s 2013 AIP expense up to an effective payout percentage or Company Performance Multiplier of 102.9%, despite the PO’s

finding at page 50 that the expense was based on the earnings per share (“EPS”) of Exelon Corporation (“Exelon”), ComEd’s parent company. As the People indicated in their Brief on Exceptions from pages 2 to 11, the Commission should, instead of allowing recovery up to 102.9%, disallow recovery of *all* of ComEd’s 2013 AIP expense, because the Proposed Order’s finding at page 50 that the 2013 AIP expense was “entirely controlled and determined” by Exelon Corp.’s earnings per share clearly necessitates, as a matter of law, that all such expense be disallowed.¹ As the People showed in their Brief on Exceptions at 7-9, Section 16-108.5(c)(4)(A) of the Energy Infrastructure Modernization Act (“EIMA”) contemplates no exception for “proportionate” disallowance or allowance of “market based” incentive compensation if the expense is based on an affiliate’s EPS. The statutory directive is clear: where incentive compensation expense is based on an affiliate’s EPS, it may not be recovered.

ComEd’s Brief on Exceptions at page 8 supports the Proposed Order’s 102.9% recovery level, calling it “reasonable” (ignoring that the PO at 50 found that “ComEd . . . failed to convince the Commission that its annual incentive plan with its EPS limiter is reasonable and prudent”); “proportionate” (without explaining what metric the 102.9% recovery level is “proportionate” to); and “legally sound” (without explaining what portion of Section 16-108.5(c)(4)(A) permits allowance of incentive compensation expense based on an affiliate’s EPS). Tellingly, ComEd’s Brief on Exceptions in support of the 102.9% proposed recovery level did not attempt to connect the Proposed Order’s proposed 102.9% recovery level to any facts of the 2013 AIP, which was not possible, because the 102.9% figure arose from facts of the

¹ The Proposed Order’s finding that the 2013 AIP was not reasonable or prudent (PO at 50) presents a separate and additional reason to disallow all such expense, under Section 16-108.5(d) of EIMA.

2010 AIP plan, as the People showed in their Reply Brief² at 16-17 and their Brief on Exceptions at 3.

In summary, *contra* ComEd's support for the Proposed Order's 102.9% recovery level, the People urge the Commission to disallow *all* of ComEd's 2013 AIP expense, rather than allowing recovery up to an effective payout percentage level of 102.9%, which has no basis in applicable law or fact related to the 2013 AIP.

II. COMED'S EXCEPTION TO THE PROPOSED ORDER IGNORES THE EXTENSIVE EVIDENCE THAT THE 2013 AIP EXPENSE WAS BASED ON EXELON'S EARNINGS PER SHARE.

ComEd makes the tendentious claim in its Brief on Exceptions at 9 that "the Proposed Order does not conclude that the entirety of ComEd's AIP is based on EPS and therefore contrary to EIMA; it is only the EPS limiter³ . . . that the Proposed Order concludes is flawed" at page 9 of its Brief on Exceptions. But ComEd appears to be a poor reader, for the Proposed Order also makes clear at page 50, in the penultimate paragraph of the Commission Analysis and

² References in this Reply Brief on Exceptions to the People's "Initial Brief" are to the People's Second Corrected Initial Brief filed September 16, 2014, and references in this Reply Brief on Exceptions to the People's "Reply Brief" are to the People's Corrected Reply Brief filed September 18, 2014.

³ It is true that the PO's Commission Analysis and Conclusion section at pages 48-50 does contain some sentences that highlight the unlawfulness of the EPS limiter in the 2013 AIP's Shareholder Protection Feature – but other statements in that section of the PO speak of the unlawfulness and the EPS-based character of AIP expense as a whole. Still, even if the Commission had expressly found *only* that AIP's Shareholder Protection Feature in particular is unlawful, that would be still be legal grounds for disallowance of all 2013 AIP expense, because the EPS limiter cannot be separated from the entirety of AIP expense. The Exelon non-GAAP EPS in 2013 was *as high as* \$2.50, *allowing* AIP pay to be paid out based on a 124.35% effective Company Performance Multiplier; had Exelon's non-GAAP EPS been as low as \$2.38, say, which would be an interpolated 80% EPS performance (*see* AG Ex. 1.7 at 3, 7 and the interpolation methodology shown at AG Ex. 3.5 at 2), then actual AIP payout would have been based on a 100% effective Company Performance Multiplier (20 percentage points above 80%; *see* AG Ex. 1.7 at 7), which is below 124.35% and also below 102.9%. Had Exelon's non-GAAP EPS for 2013 been below \$2.22, then *no AIP payout whatsoever* would have been allowed in 2013. AG Ex. 1.7 at 7; AG Initial Brief at 13; ComEd Ex. 12.0 (Rev.) at 7:136-139; Tr. at 167:7-168:5 (Brinkman). Thus, for any positive level of actual AIP payout, it is the correspondingly sufficiently high level of Exelon EPS (in addition to achievement of operational goals) that *allows* such payout under the terms of the AIP. Due to the EPS limiter, any positive amount of AIP expense actually incurred is "based on" Exelon EPS. ComEd has not made any attempt to explain how many dollars of 2013 AIP expense were lawfully incurred and how many were unlawfully incurred.

Conclusion section, that “the amount ComEd is seeking to recover for its 2013 incentive compensation expense is based on Exelon’s EPS” and that “[r]egardless of its employees’ performance on the operational metrics, the actual expense amount is more than based on Exelon’s EPS, it is entirely controlled and determined by its affiliate’s earnings per share.” The People fully support that penultimate paragraph. The Proposed Order also states on page 50 that “ComEd should work with Staff to develop an incentive compensation plan that is consistent with EIMA,” clearly implying that ComEd’s AIP plan as structured in 2013 was *not* consistent with EIMA. ComEd is simply wrong about what the Proposed Order found.

On the very same page 9 of ComEd’s Brief on Exceptions, ComEd admits that the penultimate paragraph of the PO’s Commission Analysis and Conclusion section, discussed above, is “inconsistent” with the Proposed Order’s 102.9% recovery level. ComEd’s latter claim is correct. Indeed, those well-supported findings in that penultimate paragraph are legally inconsistent with *any* recovery level above 0%, as the People showed in their Brief on Exceptions at 7-9. Thus, ComEd proposes in its Exception No. 6 to remove that penultimate paragraph from the Proposed Order (while retaining the 102.9% recovery allowance, as discussed above). But the disputed penultimate paragraph is chock-full of sound findings and should remain in the PO. For the reasons stated below (and above at footnote 3 on page 3) in this Reply Brief on Exceptions and in the People’s Initial Brief at 14-17, the contours of the Shareholder Protection Feature in ComEd’s 2013 AIP makes every dollar of expense “based on” Exelon’s EPS. ComEd witness Prescott was correct when he stated in a discovery response that “one may argue” that actual AIP payout in 2013 was “determined in part” by the Shareholder Protection Feature. AG Ex. 3.7 at 1.

Applicable caselaw and the facts of the 2013 AIP support the PO's finding in the disputed paragraph that AIP expense was "based on" Exelon EPS. The Seventh Circuit Court of Appeals case of *U.S. v. Ray*, 598 F.3d 407, 409 (7th Cir. 2010), cited by the People at pages 31-32 of their Initial Brief, established that where an agreement "clearly reflects an intent to tie" an outcome⁴ to an input factor⁵, such that if the input factor were "adjusted," the outcome would be "similarly adjusted," then the outcome pursuant to the agreement "may be said to be 'based on' " the input factor. Here, the 2013 Exelon AIP guide (AG Exhibit 1.7) shows that the level of non-GAAP Exelon EPS creates a cap on ComEd AIP payout, implying that if the cap is a binding constraint (in other words, if the payout cap created by the EPS limiter is below the actual achieved Company Performance Multiplier level, as was true in 2013), then if Exelon EPS were hypothetically one cent higher or one cent lower, AIP payout would increase or decrease. AG Initial Brief at 16; AG Ex. 3.0C at 23:519-523; Tr. at 169-173. Thus, following the Seventh Circuit's logic, ComEd's actual AIP expense "may be said to be based on" Exelon EPS.

The Illinois Appellate Court case of *Manuel v. Red Hill Community Unit School Dist. No. 10 Bd. Of Educ.*, 324 Ill.App.3d 279, 284 (5th Dist. 2001), cited by the People at page 33 of their Initial Brief, provides an alternative but equally compelling doctrinal reason to find that 2013 AIP expense was "based on" Exelon EPS. That case established that the "plain and ordinary meaning of the phrase 'liability is based on' " in a statutory provision is that the duty must be "derived from" [a variable factor⁶]. Here, the Exelon AIP guide clearly shows that the value of Exelon EPS is a necessary input factor, among others, from which the actual amount of AIP payout is derived. AG Ex. 1.7 at 7. *See also* AG Ex. 3.4 at 3; AG Ex. 3.5 at 2 (discovery

⁴ In *Ray*, the outcome in question was a federal criminal sentence.

⁵ In *Ray*, the input factor was the federal Sentencing Guidelines.

⁶ In *Red Hill*, the variable factor was a public entity's control over a property.

responses from ComEd showing how the 2013 non-GAAP Exelon EPS level of \$2.50 was used to derive the actual amount of 2013 AIP payout after considering operational goal achievements). Thus, under *Red Hill*'s logic, 2013 AIP expense was "based on" Exelon EPS.

For all the reasons stated above and in the People's Initial Brief and Reply Brief, the entirety of ComEd's 2013 AIP expense *was* indeed based on, and entirely controlled and determined by, Exelon's EPS. Thus, the contested penultimate paragraph of the PO's Commission Analysis and Conclusion section ***should be retained*** in the Commission's final Order. And in light of the findings in that penultimate paragraph that AIP expense was "entirely" based on Exelon EPS, ***no recovery*** of 2013 AIP expense may be legally allowed under Section 16-108.5(c)(4)(A) of EIMA, for all the reasons stated in the People's Brief on Exceptions from pages 3-9.

Finally, because the People advocated in their Brief on Exceptions removing discussion of any 102.9% recovery level from the Proposed Order, they also oppose ComEd's proposal in its Exception No. 6 to insert the sentence "The undisputed evidence shows that an AIP payout at 100% results in market-based salaries and 102.9% therefore allows for a small increase above market rates in recognition of above target (and exceptional) achievement on the customer focused KPI metrics." (plus citations) into the fourth paragraph of the Commission Analysis and Conclusion section. At a minimum, the portion of that sentence after the word "salaries" should not be included in the final Order.

III. REQUEST FOR ORAL ARGUMENT

The People respectfully reiterate their request for oral argument as to the AIP expense recovery issue, first made in their Brief on Exceptions. As the discussion in this Reply Brief on

Exceptions makes clear, the issues presented with respect to the 2013 Annual Incentive Program and its Shareholder Protection Feature are complex, and the Commission would thus benefit from oral argument on this matter.

IV. CONCLUSION

WHEREFORE, the People of the State of Illinois respectfully request that the Commission enter a final order consistent with the recommendations in this Reply Brief on Exceptions, their Brief on Exceptions, and their Initial and Reply Briefs.

Respectfully submitted,

PEOPLE OF THE STATE OF ILLINOIS

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